

PROGRAM EVALUATION REPORT

WEST VIRGINIA

Drinking Water Treatment Revolving Fund Program

STATE FISCAL YEAR 2007

FINAL

October 2008

**U.S. Environmental Protection Agency
Region III
Philadelphia**

TABLE OF CONTENTS

EXECUTIVE SUMMARY	3
INTRODUCTION.....	5
OBSERVATIONS.....	7
PROGRAMMATIC AREAS REVIEWED.....	7
PUBLIC HEALTH BENEFITS.....	7
PROGRAM PACE.....	8
UNEXPENDED GRANT BALANCES.....	9
SMALL AND DISADVANTAGED ASSISTANCE.....	10
SUSTAINABLE INFRASTRUCTURE.....	10
OPERATING AGREEMENT	11
PROGRAMMATTIC REPORTING	11
ENVIRONMENTAL REVIEW	12
SET-ASIDE ACTIVITIES.....	12
FINANCIAL AREAS REVIEWED.....	14
HEALTH OF THE FUND.....	14
DWTRF FINANCIAL INDICATORS	17
AUDITS OF THE FUND	18
LOAN MONITORING	19
GRANT COMPLIANCE AREAS REVIEWED	21
PAYMENTS	21
STATE MATCH.....	21
BINDING COMMITMENTS	21
FINANCIAL STATUS REPORTS (FSRs).....	21
FEDERAL CASH TRANSACTIONS REPORTS	22
ADMINISTRATIVE COSTS.....	22
RECOMMENDATIONS AND REQUIREMENTS	23
ACTION ITEMS FOR BPH	23
ACTION ITEMS FOR EPA	24
PRIOR YEAR ACTION ITEMS	24
PRIOR YEAR ACTION ITEMS FOR BPH	24
PRIOR YEAR ACTION ITEMS FOR EPA	25

PROGRAM EVALUATION REPORT
West Virginia
Drinking Water Treatment Revolving Fund

STATE FISCAL YEAR 2007

EXECUTIVE SUMMARY

This Program Evaluation Report (PER) is the U.S. Environmental Protection Agency (EPA) evaluation of the West Virginia Bureau of Public Health's (BPH's) Drinking Water Treatment Revolving Fund (DWTRF) program. The report identifies strengths and areas for improvement in the program. The review covers the period July 1, 2006 through June 30, 2007. EPA conducted its on-site financial review from May 13 - 15, and its programmatic review from June 3-5, 2008.

The State continues to do an excellent job of meeting the needs of small and disadvantaged communities. The program exhibits sound financial strength. EPA, however, continues to be concerned that the low Return on Equity (ROE, 1.61%) resulting from very low average interest rates on loans will limit the financial growth of the Fund, reducing the purchasing power of the Fund over time.

The State met the binding commitment (BC) requirement during FY 2007, however the State's program pace decreased to 73% from 76% in FY 2006. BPH continues to lag far behind the national average (88%) for loan closings as a percentage of total funds available. The slow pace will also limit the growth of the Fund.

The PER identifies recommended and required actions for the State to address including:

- Continue efforts to fill grant-funded positions needed to manage DWTRF and earmark projects;
- Reduce the unexpended balance of grant funds in the infrastructure and set-aside accounts;
- Review the procurement process to identify delays and implement measures to expedite set-aside procurement actions;
- Implement options for utilizing set-aside funds in a more timely manner;
- Implement measures to draw funds from the oldest grants first;
- Submit a copy of its reconciliation of FY 2006 and 2007 Single Audit expenditures to EPA within 30 days of receipt of the draft PER;
- Increase efforts to obtain required financial statement audits from each borrower annually; and

- Reconcile the Financial Status Reports (FSRs) and Financial Cash Transaction Reports (FCTRs) and provide EPA with the supporting documentation.

EPA requests that the State respond to the identified FY 2007 action items as well as the unresolved FY 2006 PER action items concerning set-aside expenditures within 30 days of receipt of the final FY 2007 PER. In its response, the State should identify actions that it has already taken and outline a plan and schedule for expeditiously taking additional steps to address the identified concerns. A meeting is scheduled for November 7, 2008 in Charleston to further discuss follow-up action.

INTRODUCTION

PURPOSE

The purpose of an annual review is to assess the State's management of the program, including:

- Performance in achieving goals and objectives identified in the Intended Use Plans (IUPs) and Annual Report;
- Compliance with the terms of the capitalization grant agreements, Operating Agreement (OA), and regulations;
- Financial status and performance of the Fund and set-aside accounts;
- Status of resolution of prior year PER action items;
- Resolution of audit findings and recommendations; and
- Discussion of future direction and initiatives for the program.

SCOPE

The FY 2007 annual review of West Virginia's DWTRF program was conducted in accordance with EPA's Interim Final Annual Review Guidance and Region III's Annual Review Plan dated September 28, 2007. The annual review process included EPA's consideration of BPH's Annual Report, evaluation of the State's program, and issuance of this PER.

EPA conducts separate reviews of the technical aspects of the drinking water program activities undertaken with set-aside funds in conjunction with its review of the State's Public Water System Supervision (PWSS) program. The current DWSRF review examined the administrative and financial aspects of the set-aside activities.

This PER reflects EPA's evaluation of West Virginia's DWTRF program and documents the annual review process as required by the Safe Drinking Water Act (SDWA). This PER identifies strengths and areas for improvement in the program. The annual review covered the period July 1, 2006 through June 30, 2007. EPA conducted its on-site review from May 13 -15, and June 3-5, 2008.

BACKGROUND

Title 64 of the West Virginia Code, authorized BPH to implement and manage the DWTRF program in accordance with the requirements and objectives of the Safe Drinking Water Act. The DWTRF program resides in the Department of Health and Human Resources (DHHR) which also provides management for SRF financial matters, including grants management and disbursement of funds. Additional coordination with offices of the State Treasurer and the State Auditor ensure proper coordination, management, and oversight as well as program integrity.

In addition to the DWTRF construction fund, BPH administers several set-aside accounts used for: (1) administration of the loan program, (2) small system technical assistance, (3) state program management, and (4) local assistance and other state activities.

As of June 30, 2007, total capitalization for the DWTRF project fund and drinking water set-aside program activities is \$90,402,240, which consists of Federal grant funds and state match. During FY 2007, BPH closed three loans for a total of \$4,585,500. On a cumulative basis, the State has made 34 loans totaling \$58,131,471.

OBSERVATIONS

PROGRAMMATIC AREAS REVIEWED

PUBLIC HEALTH BENEFITS

Consistent with EPA's supplemental guidance, BPH described the public health benefits of the drinking water projects in its IUPs and in its Interim Annual Report. EPA commends BPH for its detailed benefit descriptions. In its Annual Report, the State highlighted the two projects shown below.

The Masontown water treatment facility was built in the late 1970s and its raw water supply reservoir did not meet current design standards. The water system had several violations of both State and Federal safe drinking water requirements, including inadequate turbidity monitoring, high turbidity levels in the filtered water, and maximum contaminant level (MCL) violations for Total Trihalomethanes (TTHM) exposing customers to disinfection by-products.

To correct these violations and ongoing health threats, the most cost-effective solution was to remove the Masontown water treatment plant from service and connect to the Morgantown Utility Board, made possible with a DWTRF loan of \$635,500 (0% for 30 years) and a State Infrastructure and Jobs Development Council loan of \$815,000. Morgantown is in compliance with turbidity and TTHM requirements and provides safe drinking water to 749 existing and 11 new customers.

The Ceredo Water Department system had primarily small diameter (less than 6 inches) water distribution lines within the project area and most customers were supplied directly from pumps. Many areas served by the water system suffered from inadequate pressure and associated public health threats due to reservoir elevation and inadequate booster pump stations. The State's Public Service Commission ordered Ceredo to correct low pressure problems throughout the distribution system.

A DWTRF loan of \$2,700,000 (0% for 30 years) covered the total project cost for upgrades to the distribution system and eliminated the need for a supplemental groundwater source that did not have disinfection capabilities. Inadequate lines were replaced with properly sized lines. This project resulted from a comprehensive evaluation of the entire distribution system to identify the most economical solutions for providing 2,317 customers with a safe and reliable water supply.

PROGRAM PACE

During FY 2007, BPH closed three drinking water loans totaling \$4,585,500. Although the State's goal is to improve program pace, BPH's fund utilization rate (program pace) decreased from 76% to 73% for FY 2007, lower than the national average (88%). Inadequate staffing is a major obstacle to improving pace. At the time of the onsite review, the assistant DWTRF manager and Congressional earmarks manager positions were vacant and for several months the DWTRF program manager was responsible for the DWTRF and earmark projects. Additional staff is needed to follow up on project milestones and move applicants to closing. Although BPH has advertised the vacancies, it has been difficult to fill the positions because the engineer salaries have not been competitive with other State agencies, including the Department of Environmental Protection. In April, 2008, the Governor approved a 10% raise for engineer positions in all State agencies, raising the likelihood that BPH will be able to fill the positions. EPA commends for BPH for efforts to reduce the impact of the vacancies by temporarily re-assigning staff to assist with DWSRF projects.

The State has taken steps to increase pace, including:

- Marketing the DWTRF program at the West Virginia Rural Water Association Conference and the West Virginia Infrastructure and Jobs Development Council (IJDC) meetings; the West Virginia EXPO in Charleston; and publishing articles in the West Virginia Rural Water Association Magazine and the West Virginia Bureau for Public Health and Public Service Commission Newsletters for water treatment operators;
- Sending BC letters prior to DWSRF grant award to streamline the loan process;
- Continuing to work on the goal of closing loans within 18 months of issuing the binding commitment.
- Advertising its planning and design grant program resulting in 70 applications for \$1.85 million available from the local assistance set-aside. At the time of the Annual Review, BPH was setting priorities for awarding these grants.

Action Item: BPH must identify and implement additional measures to increase the pace of loan closing.

BPH should continue efforts to fill vacant DWTRF and earmark project management positions.

UNEXPENDED GRANT BALANCES

Unexpended grant balances in all EPA grant programs, especially related to older grants, continue to be a Congressional and Agency concern. Congress, the Government Accountability Office, and the Office of Management and Budget (OMB) are reviewing and documenting such balances. EPA has not yet reassessed SRF guidance and procedures regarding expenditures. However, to avoid potential reductions in future appropriations or actions to recover unspent grant funds, EPA encourages states to take appropriate steps to avoid the appearance that grant funds are not needed or are not being used expeditiously. Such steps include drawing funds from the oldest grants first and drawing funds in a timely manner, and applying for the entire grant allocation in the first year of availability. If additional national guidance is developed regarding expectations or methods to reduce grant balances, EPA will provide it to the State.

States have discretion to determine how capitalization grant funds should be allocated between the infrastructure and set-aside accounts. Once funds have been awarded, states should closely monitor the spending rates and, as appropriate, make adjustments such as shifting money among set-aside accounts and between set-aside accounts and the infrastructure fund. EPA does not recommend that BPH move additional funding into infrastructure until pace goals are achieved.

During the review period, BPH had four open grants with unexpended balances. BPH should continue to review the unexpended balance of grant funds and take appropriate actions to accelerate spending for both infrastructure and set-asides. EPA financial records show that BPH's practice of drawing from all open grants has prevented older grants from being closed out in a timely manner. BPH should instead use first-in, first-out accounting to improve the efficiency of grants management.

In the past, EPA extended grants to give states additional time to draw funds; EPA is now re-assessing extensions for grants open longer than four years in light of concerns about unliquidated obligations. Instead of extending older grants, EPA has the option of allowing grants to expire and requiring states to reapply for the remaining funds.

BPH has generally applied for grant funds in the second year of availability because of slow pace in the infrastructure program. With increased attention of oversight agencies regarding the timing of grant funds obligation and expenditure, EPA advises the State to work toward the goal of applying for future Federal allocations in the first year of availability.

Action Items: BPH must take appropriate actions to accelerate spending for both infrastructure and set-asides.

BPH must implement measures to draw funds from the oldest grants first.

SMALL AND DISADVANTAGED ASSISTANCE

BPH has done an excellent job of meeting the needs of small and disadvantaged drinking water systems. The State has exceeded the SDWA minimum requirement to provide 15% of available funding to small systems (up to 10,000 population). As of June 30, 2007, the State had provided 31 loans to small systems totaling \$45.6 million, or 78% of total loan dollars. This exceeded the national average of 39%, placing BPH among the top ten states in small system funding. BPH also provided 25 loans totaling \$40.2 million to disadvantaged systems (minimum interest rate of 0% and repayment terms of up to 30 years). This represents 69.2% of total loan dollars, exceeding the national average of 18% and placing the State among the top five states for disadvantaged funding. EPA commends BPH for its commitment to providing DWTRF assistance to small and disadvantaged communities.

SUSTAINABLE INFRASTRUCTURE

The Sustainable Infrastructure (SI) initiative was launched by EPA's Office of Water as a collaboration with state and local officials, utility managers, trade associations, and watershed organizations to promote sustainable practices that will help reduce the potential gap between funding needs and spending at the local and national level. This initiative is intended to change how the nation views, values, manages, and invests in its water infrastructure. EPA and its state partners are working with the water industry to identify best practices to help utilities address a variety of management challenges. States are encouraged to work with communities to implement SI best management practices to not only replace aging infrastructure, but also extend the service life and reduce life cycle costs of facilities and contribute to reduction of public health problems.

EPA encourages states to seek opportunities to incorporate SI principles into the DWSRF program. States can include bonus points in priority systems, inform SRF applicants that SI practices and technologies are eligible under the SRF program, and provide incentives such as reduced interest rates to applicants that incorporate SI approaches.

The State is carrying out several SI activities. To encourage full cost pricing, the IJDC reviews all projects requesting State and Federal funds to insure that water systems have adequate revenue from user rates to ensure a positive annual cash flow and adequate debt service coverage.

The better management pillar is supported by BPH's capacity development program which conducts water system assessments to identify improvements that support water system long-term viability. BPH provides an asset model with current prices for equipment and facilities to educate water systems on the value of their assets. The capacity development staff also works with non-compliant water systems, many of

which rely on volunteers to operate the system, to help them identify alternatives for making their systems viable.

EPA commends the State for its participation in the SI forum and for its willingness to promote SI activities. As available, EPA will provide the State information on best practices from other states on how SI can be implemented in the DWSRF.

OPERATING AGREEMENT

BPH prepared and submitted to EPA for consideration proposed amendments to the Operating Agreement (OA).

Action Item: EPA will review BPH's proposed amendments to the OA and work with the State to adopt the amended OA.

PROGRAMMATTIC REPORTING

Drinking Water National Information Management System (DWNIMS)

BPH submitted its DWNIMS data in a timely manner. Any differences in amounts between DWNIMS and the Annual Report are minor and are due to timing. (DWNIMS is prepared earlier than the Annual Report.) BPH will reconcile differences and make necessary changes to DWNIMS during the next reporting cycle (August 2008).

Annual Report

Although the DWSRF regulations require states to submit a Biennial Report, BPH submits an Annual Report. EPA commends BPH for reporting more frequently, facilitating EPA's annual review process. The State submitted its FY 2007 Annual Report on time.

The report complied with SDWA, DWSRF regulations, and Region III Supplemental Guidance with respect to the following:

- All of the required compliance statements and financial charts, and
- A description of how the short-term and long-term IUP goals were fulfilled.

Minority/Women's Business Enterprises (M/WBE)

States must comply with 40 CFR 35.3580 regarding the six "affirmative steps" to ensure that qualifying M/WBE firms have an opportunity to compete for prime contracts and sub-contracts. EPA did not perform a review of file documentation related to documentation of compliance with the six affirmative steps as part of the FY 2007

annual review. As discussed at the Region III States meeting, the FY 2008 annual review will include implementation of the new Disadvantaged Business Enterprise regulations.

ENVIRONMENTAL REVIEW

EPA reviewed the State's project files for the City of Fairmont, Sun Valley PSD and Masontown Water Works for consistency of BPH's environmental review documentation with its approved State Environmental Review Process (SERP). The files included a cross-cutter checklist to document compliance with each cross-cutting requirement and sufficient documentation to show that BPH's issuance of a Finding of No Significant Impact for each project was consistent with the SERP.

SET-ASIDE ACTIVITIES

Set-Aside Expenditures and Obligations

The table below shows the State's progress in obligating and expending funds on a cumulative basis for each set-aside category. As of June 30, 2007, the national cumulative average rates of state set-aside expenditures were 73.4% for Technical Assistance, 77.1% for Program Management, and 65.1% for Local Assistance.

The table shows that BPH's cumulative expenditure rate for the Technical Assistance set-aside is much higher than the national average and below the national average for the Program Management and Local Assistance set-aside categories. (The cumulative expenditures for the Program Management set-aside reported in DWNIMS includes the cash one to one match, while the chart below does not.)

SET-ASIDE UTILIZATION FOR ALL GRANTS Cumulative As of June 30, 2007				
	Technical Assistance	Program Management	Local Assistance	Total
CUMULATIVE AWARDED	\$1,494,425	\$6,774,162	\$9,058,581	\$17,327,168
CUMULATIVE OBLIGATED	\$1,479,854	\$4,649,301	\$5,757,160	\$11,886,315
% OBLIGATED	99.0%	68.6%	63.5%	68.6%
*EXPENDED	\$1,494,425	\$4,525,992	\$5,715,741	\$11,650,733
% EXPENDED	94.3%	66.8%	63.1%	67.4%
% EXPENDED U.S. AVG	73.4%	77.1%	65.1%	71.2%

*Source: DWNIMS

Revised Set-Aside Spending Plan

Although the State has revised prior year work plans to redirect set-aside funding to new activities, this redirection has not increased the rate of spending. A major cause of the low set-aside expenditure rate has been delays in the procurement process. BPH agreed to analyze the reasons for these delays and to take action to improve the process, including training staff in how to develop the appropriate procurement agreement needed to carry out program goals. BPH believes that once contracts are in place, monies will be expended quickly. In addition, salaries for engineers were increased statewide, and with this, BPH expects to draw an additional \$210,000 per year in grant funds.

EPA will continue to monitor set-aside spending. If the above changes do not increase set-aside expenditures, BPH must consider timely and appropriate options including directing funds to activities to improve readiness of loan applicants to proceed to loan closing; deobligation of funds from older grants; transferring unused set-aside funding into infrastructure for a possible principal forgiveness program; transferring funds to the Clean Water Revolving Loan Fund, and similar measures. Future set-aside grant awards may be impacted. Note that the 2% and 10% set-asides may be reserved for future use but the 15% cannot be reserved. EPA will arrange a convenient time with BPH to discuss progress and options in more detail.

A more detailed analysis of the State's progress in expending set-aside funds and accomplishing work plan activities is conducted as part of EPA's drinking water program oversight process.

- Action Items:**
- BPH must review the procurement process to identify delays and implement measures to reduce delays in funding set-aside procurement actions.
 - BPH must implement options for utilizing set-aside funds in a more timely manner.
 - EPA will arrange a convenient time with BPH to discuss progress and options in more detail.

OBSERVATIONS

FINANCIAL AREAS REVIEWED

HEALTH OF THE FUND

Capitalization grants and state match earmarked for the DWTRF as of June 30, 2007 totaled \$90,402,240. The overall financial growth of the DWTRF has been good due to the continuation of EPA grants and state match funding. As of June 30, 2007, net assets of the DWTRF loan fund were approximately \$60,012,044, not counting \$19,960,516 in unexpended Federal capitalization grant funds. That is 20 percent over FY 2006 net assets of \$50,040,081. Net assets include \$56,430,514 in EPA grants and state match received and \$3,581,530 in net loan and investment interest, and user fees received. Almost all of the growth in net assets to date is from the EPA grants and state match received.

The financial health of the West Virginia DWTRF program currently is good. All loans are secured by system revenues and reserves pledged by the borrowing entities. The DWTRF fund account has a strong cash flow. Financial management is sound; the State's internal controls are in place; there is no debt; and, there have been no loan defaults. A summary of the financial status of the DWTRF program is shown in the table below:

Financial Health Summary As of June 30, 2007	
Cumulative Federal Grants & State Match	\$90,402,240
Net Assets	\$60,012,044
Loan Repayments	\$7,601,604
Investment Earnings	\$2,114,998
Loan Disbursements	\$53,973,859

As of June 30, 2007, BPH and WDA have closed 34 loans totaling \$58,131,471, of which, \$47,648,028 is outstanding as loans receivable.

The State Treasurer invests DWTRF funds in the Cash Liquidity Pool managed by the West Virginia Board of Treasury Investments (BTI). BTI investments include very safe securities such as U.S. Government obligations, repurchase agreements, highly-rated corporate bonds, and commercial paper. U.S. Government obligations are secured by the full faith and credit of the U.S. Government. The corporate bonds and

other securities have high ratings because they are not likely to default. BTI repurchase agreements are collateralized by U.S. Treasury securities at 102 percent of principal. Approximately 98 percent of the Cash Liquidity Pool is rated 'A' or better by Moody's and S & P credit rating agencies.

The 12-month average yield for the Cash Liquidity Pool for the FYE June 30, 2007 was 5.41%, according to the West Virginia Comprehensive Annual Financial Report (CAFR) dated June 30, 2007.

Return on Equity (ROE) is a measure of the growth of capital within the DWTRF. The ROE for the DWTRF was 1.61% for FY 2007, which is virtually the same as the ROE for FY 2006 (1.60%). An ROE of 1.61% for a subsidized lending program that issues loans for rates between 0 and 2% is not unexpected; however, it will not maintain purchasing power if the rate of inflation over time is higher than 1.61%.

In addition, the relatively low 1.61% ROE indicates that the DWTRF is not sufficiently accumulating capital from its lending and investing activities to achieve significant financial growth. This provides further evidence that most of the financial growth in the DWTRF is due to EPA grants and state match.

In the FY 2006 PER, EPA recommended that BPH reconsider its policies and procedures for determining the interest rate terms on DWTRF loans and for assessing program fees. In its response dated December 31, 2007, BPH essentially reaffirmed that it cannot change its current loan terms without turning many borrowers away and significantly decreasing the pace at which DWTRF loans are made. From this response, it appeared that BPH believes its current policies and procedures optimize the Fund goals and does not think it is wise to change the terms it offers potential DWTRF borrowers. However, during the on-site visit to BPH in May 2008, BPH informed EPA that it was considering a change to its current definition of disadvantaged communities from 1.25% median household income (MHI) to 1.5% MHI. Such a change may result in loan terms that yield additional loan interest income and larger cash flows to the DWTRF.

As was done previously, BPH prepared long-term, baseline financial projections for the DWTRF based upon current financial policies (e.g., interest rates, loan terms, charging of construction period interest), and historic DWNIMS data as of June 30, 2007. EPA provided assistance to BPH in using the EPA Financial Planning Model.

The projections showed results similar to those reported in the 2006 PER. After all Federal grants and state match funds are spent the DWSTRF will only be able to sustain average annual disbursements of approximately \$8.5 million through 2037. Cumulative loan disbursements at that time will be approximately \$375 million. Total assets in the fund will grow to approximately \$200 million. This projection did not consider the effects of inflation on these amounts, because the assumptions used in this modeling were very broad and very conservative.

EPA and BPH decided that additional modeling using a variety of possible scenarios is necessary to produce more accurate and effective modeled results; however, the projections described above indicate a fund that will not achieve any significant growth in nominal dollars, much less so if inflation is considered. In addition, more information regarding the prospective pool or type of borrowers is needed from BPH and WDA to properly formulate assumptions regarding loan terms and interest rates.

In light of the cash flow projections above, EPA reiterates its position that BPH consider changing the terms it provides borrowers that receive disadvantaged assistance to ensure that the DWTRF will continue to provide loan assistance in perpetuity as required by SDWA.

With respect to the administrative fee charged (1% on most loans), some of this fee, especially on 0% loans, could be charged as loan interest and deposited into the DWTRF to increase the amount of revenue available in the future to finance new loans and generate real economic growth to the DWTRF. In its December 31, 2007 response to the FY 2006 PER, BPH stated that it wishes to accumulate \$1,000,000 in administrative fees to invest with the state Treasurer to generate annual administrative revenues. EPA believes that this approach ties up too much money now to fund future administrative costs. Fees should be charged at a level consistent with the required average annual administrative costs to operate the program effectively. Instead of charging 0.5% fees to disadvantaged borrowers, BPH should charge 0.25% in fees plus 0.25% in interest. Following this approach, BPH will maintain the perpetuity of the fund while providing adequate resources for administrative costs without increasing the costs to the disadvantaged borrowers which otherwise would decrease the fund utilization rate.

In summary, the overall financial health of the DWTRF is good. Thorough financial capability and credit analysis; the strength of the revenue and reserves pledged; the loan monitoring system in place; good accounting, financial reporting and audit processes; safe and efficient investment policies; and a strong loan repayment and collection system, indicate that BPH and WDA are maintaining the resources already deposited into the DWTRF. However, there are challenges that threaten its ability to address the critical drinking water infrastructure needs in the future. Significant amounts lent at 0% for 30 years, high administrative fees, and not charging interest during the construction period are severely limiting the ability of the DWSTRF to grow at a rate that will allow it to remain an effective source of drinking water infrastructure financing. In short, the DWSRF may not be an adequate source of financing state needs in perpetuity, once EPA grants are no longer appropriated.

Action Items: EPA and BPH should conduct additional financial modeling to better understand various interest rate/program fee scenarios and to manage the Fund in perpetuity.

BPH should pursue a 1.5% MHI disadvantaged assistance threshold to determine the terms of assistance it will provide to future borrowers.

BPH should consider adjusting its policies regarding administrative fees and construction period interest.

DWTRF FINANCIAL INDICATORS

All of the indicators generally demonstrate that the DWTRF program's financial performance is good. However, funds are not being committed to loans commensurate with EPA expectations. Note that each of the indicators reflects calculations on a cumulative basis:

NIMS Financial Indicators for DWSRF				
Indicator	2005	2006	2007	National Average
Program Pace (Loans as a % of Funds Available)	63%	76%	73%	88%
Return on Federal Investment	138%	131%	137%	177%
Disbursements as a % of Assistance	86%	78%	92%	80%
Net Return After Forgiving Principal	\$1,882,647	\$2,562,867	\$3,410,770	—
Net Return on Contributed Capital	5.5%	5.9%	6.5%	5.1%

Program Pace (Loans as a % of Funds Available)

The Loans to Funds Available indicator represents the percent of money available in the DWTRF program which has been lent (i.e., executed loans). Performance on this critical indicator decreased to 73% from 76% in 2006, and it remains far below the national average (88%). EPA's Strategic Plan includes a program activity measure on Fund Utilization which is comparable to the program pace indicator reported in DWNIMS. As discussed in the "Program Pace" section of the PER, BPH must take additional measures to increase the pace of loan issuance.

Return on Federal Investment

The Return on Federal Investment indicator shows the amount of financial assistance or loans disbursed for each dollar of Federal cash draws made on a cumulative basis. The national average for this indicator is 177%. The State's result on this indicator is far below the national average; however, it reflects an increase from 2006 (131%). Increasing the pace of loan closings will positively impact this measure. This indicator measures actual funds disbursements. Therefore, the focus is on the

pace of project construction and reimbursement of incurred expenses. For closed loans, the State should regularly monitor project construction and, as appropriate, assist loan recipients in resolving construction delays.

Disbursements as a Percentage of Assistance

Loan Disbursements as a Percentage of Assistance Provided shows the speed at which funds are disbursed to closed loans. It is calculated by dividing cumulative loan disbursements by cumulative assistance provided. The value of the indicator ranges from 0% to no more than 100%. It increased significantly during FY 2007 to 92%, which is above the national average (80%). This shows that, although BPH is not closing loans at the expected pace, when it closes loans, BPH is timely in disbursing funds and completing projects.

Net Return after Forgiving Principal

Net Return after Forgiving Principal, also called Net Return, shows the net earnings of the DWSRF after loan principal has been forgiven. The Net Return indicator shows how well the DWSRF is maintaining invested or contributed capital. The operating earnings are calculated first by subtracting the net bond interest expenses. Then match bond principal and loan principal forgiven are subtracted from these earnings to yield the net return to the DWTRF. West Virginia does not issue bonds to generate its state match and does not offer principal forgiveness on loans. (If provided, loan forgiveness would be a reduction in the amount of contributed capital or an expense against operating revenues.) The Net Return indicator shows how well the DWTRF is maintaining invested or contributed capital. Note that performance is expected to be a net positive return.

Net Return on Contributed Capital

Net Return on Contributed Capital gives context to the Net Return indicator by comparing the net return of the DWTRF to the dollar amount of contributed capital. It is calculated by dividing the Net Return by cumulative contributed capital and expressed as a percentage. Another way of stating this rate is that as of June 30, 2007, the DWTRF returned approximately \$1.07 for each dollar of contributed capital invested. Contributed capital is equal to total Federal cash draws less set-aside expenses plus state match deposited into the DWTRF. The net return increased to 6.5% in 2007.

While BPH has a net return on contributed capital that is above 0%, a 6.5% net return is still a very low cumulative rate of return on capital.

AUDITS OF THE FUND

On October 5, 2007, the independent certified public accountants (CPAs) issued their opinion on the DWTRF audited financial statements which includes the State

construction loan portion of the BPH DWTRF. The auditors expressed an unqualified opinion on these financial statements, indicating that they are fairly presented and conform to generally accepted accounting principles.

As part of their audit, the CPAs performed a Single Program Audit of the State's Federal financial assistance in accordance with generally accepted governmental auditing standards and Office of Management and Budget (OMB) Circular A-133, and issued that report on the same date as the financial statements. There were no notes or disclosures indicating any deficiencies in the State's accounting system or internal controls. In addition, the audit contained no findings of non-compliance with Federal regulations.

With respect to Audit Finding 2006-01 Sub-recipient audits in the FY 2006 DWTRF audit, the finding was resolved. EPA did not agree with the CPAs' basis for the finding, and EPA policy was revised to clarify the extent of sub-recipient audit requirements.

The FY 2007 West Virginia Statewide Single Audit has been issued. It contained no DWTRF findings. The Single Audit covers both set-aside and project loan expenditures. Total FY 2007 Federal expenditures related to the DWTRF program identified in the Single Audit were \$10,831,167 determined on a cash basis. This amount does not agree with the total expenditures reported on the FY 2007 FSR of \$9,281,359. During the on-site visit to BPH, the accountant stated that a reconciliation of the FY 2006 and 2007 Single Audit expenditures to BPH accounting records and the FSRs was being prepared.

Action Item: BPH must submit a copy of its reconciliation of FY 2006 and 2007 Single Audit expenditures to its accounting records and FSRs to EPA within 30 days of receipt of the draft PER.

LOAN MONITORING

EPA reviewed the State's loan compliance monitoring program procedures and found them effective. The system includes a review of the Municipal Bond Commission (MBC) collection reports on each of BPH's loans, the annual budgets of all borrowers, and annual financial statement audits for all of borrowers. In addition, required Single Audits are reviewed and any findings and recommendations resolved.

In addition, the State uses the MBC as the collection agent on all loans. The MBC's rate coverage and debt service reserve requirements reduce the likelihood of delinquencies or loan defaults.

EPA limited its review of loan monitoring to a review of the borrower audit tracking sheets and information reported in the Annual Report. No borrowers were selected for review.

According to the audit tracking sheets included in the Annual Report, several audits have not been received from FY 2004 through FY 2006. WDA and BPH have been working to improve the timeliness of these audits.

Action Item: WDA and BPH should increase efforts to obtain required financial statement audits from each borrower annually.

ERRONEOUS PAYMENTS REVIEW

EPA tested two BPH DWTRF cash draws totaling \$1,426,800.68 of a total of \$10,894,371 EPA cash draws for FY 2007, to determine if BPH made any erroneous payments:

Grant No.	Date	Amount
FS-99390003	12/11/2006	\$1,316,478.00
FS-99390003	1/29/2007	110,322.68
Total		\$1,426,800.68

EPA found that the selected cash draws were properly made for eligible DWTRF expenditures and were properly recorded in the BPH accounting records.

OBSERVATIONS

GRANT COMPLIANCE AREAS REVIEWED

PAYMENTS

Consistent with the payment schedules in the grant agreements, during FY 2007 EPA released and the State accepted Federal payments totaling \$10,695,539 from the Automated Standard Application for Payments (ASAP) account. Of this amount, \$8,124,392 was for projects and \$2,571,147 was for set-asides. Cumulative payments as of June 30, 2007, totaled \$70,770,635: \$51,971,847 for projects and \$18,798,788 for set-asides.

STATE MATCH

Based on cumulative Federal payments as of June 30, 2007, the required match was \$14,104,217. As of June 30, 2007, the State had deposited \$15,067,040 into the Fund, as shown in the State's FY 2007 Annual Report. BPH met the 20% state match requirement for projects. This agrees with the amount reported in DWNIMS.

Under the Program Management set-aside, BPH was required to provide \$913,044 in state match funds based on disbursements made during FY 2007. The State provided \$913,044 as shown in the State's FY 2007 Annual Report. This agrees with the amount reported in DWNIMS.

BINDING COMMITMENTS

Total BCs required as of June 30, 2007 were \$55,596,775 based on Federal grant payments of \$43,847,455 and a state match of \$11,749,320. Actual BCs as of June 30, 2007 were \$67,789,986. The State exceeded the BC requirement by approximately \$12,193,211. The State complied with the BC requirement for each quarter of FY 2007.

FINANCIAL STATUS REPORTS (FSRs)

BPH reported \$9,281,359.12 in Federal outlays on the FSRs submitted for the reporting period July 1, 2006, to June 30, 2007. The amount of net disbursements reported on the FCTRs were \$9,344,563.38. This results in a difference of \$63,204.26 between the two reports. The FSRs are reported on a cash basis; therefore, BPH must provide EPA with the information needed in order to reconcile the two reports.

FEDERAL CASH TRANSACTIONS REPORTS

The State's FCTRs showed capitalization grant receipts of \$9,344,563.38. However, there is a \$1,549,808 difference between what the state reported as having received and what EPA grant payment records show (\$10,894,371.38). The \$1,549,808 reverses the difference that was reported between the State and EPA during State's FY 2006. BPH also reported net disbursements of \$9,344,563.38 which is a difference of \$63,204.26 from the expenditures reported to EPA on the FSRs.

Action Item: BPH must reconcile the FSRs and FCTRs and provide EPA with the supporting documentation.

ADMINISTRATIVE COSTS

In its FY 2007 Annual Report, the State shows administrative expense disbursements of \$253,390 for the reporting period and \$2,072,961.25 cumulatively. However, these amounts do not agree with what is reported in DWNIMS (\$256,827 and \$2,078,121). The differences between the two reports are (\$3,437.31 and \$5,159.75 respectively). Notwithstanding the differences in the annual and cumulative amounts reported in the Annual Report and the DWNIMS report, cumulative administrative costs represent 2.75% of the total capitalization grants awarded to BPH. This is within the 4% ceiling set by the SDWA.

Action Item: BPH must make the necessary adjustments between the Annual Report and DWNIMS and provide corrected reports to EPA.

RECOMMENDATIONS AND REQUIREMENTS

ACTION ITEMS FOR BPH

1. BPH must identify and implement additional measures to increase the pace of loan closing.
2. BPH should continue efforts to fill vacant DWTRF and earmark project management positions.
3. BPH must take appropriate actions to accelerate spending for both infrastructure and set-asides.
4. BPH must implement measures to draw funds from oldest grants first.
5. BPH must review the procurement process to identify delays and implement measures to reduce delays in set-aside funded procurement actions.
6. BPH must implement options for utilizing set-aside funds in a more timely manner.
7. BPH should pursue a 1.5% MHI disadvantaged assistance threshold to determine the terms of assistance it will provide to future borrowers.
8. BPH should consider adjusting its policies regarding administrative fees and construction period interest.
9. BPH must submit a copy of its reconciliation of FY 2006 and 2007 Single Audit expenditures to its accounting records and FSRs to EPA within 30 days of receipt of the draft PER.
10. WDA and BPH should increase efforts to obtain required financial statement audits from each borrower annually.
11. BPH must reconcile the FSRs and FCTRs and provide EPA with the supporting documentation.
12. BPH must make the necessary adjustments between the Annual Report and DWNIMS and provide corrected reports to EPA.

ACTION ITEMS FOR EPA

1. EPA will review BP's proposed amendments to the OA and work with the State to adopt the amended OA.
2. EPA will arrange a convenient time with BPH to discuss progress and options in more detail.
3. EPA and BPH should conduct additional financial modeling to better understand various interest rate/program fee scenarios and to manage the Fund in perpetuity.

PRIOR YEAR ACTION ITEMS

PRIOR YEAR ACTION ITEMS FOR BPH

1. BPH shall submit a program pace implementation plan which identifies the priorities and schedule for carrying out the recommendations in the report "Increased Utilization of West Virginia's Drinking Water Treatment Revolving Fund." **BPH's pace improvement plan has been affected by project management position vacancies.**
2. BPH shall re-assess how existing awarded set-aside funds can effectively be used to increase loan pace and to support other drinking water program priorities. BPH should review the need for additional funding in the Program Management and Local Assistance set-aside categories from future grants. If these measures do not sufficiently increase the rate of set-aside funds expenditure, BPH should consider transferring surplus set-aside funds to the DWTRF project fund. **Not resolved. BPH has made some progress**
3. BPH should reconsider its policies and procedures for determining the interest rate terms on DWTRF loans and for assessing program fees. **In process.**
4. BPH should take appropriate steps to expedite expenditure and cash draws of Federal funds available for the DWTRF program. **Not resolved.**
5. BPH must provide EPA with supporting documentation so that EPA is able to reconcile the FSRs and FCTRs. **Resolved.**
6. BPH must make the necessary adjustments regarding administrative costs between the Annual Report and DWNIMS and provide to EPA corrected reports. **Resolved.**

PRIOR YEAR ACTION ITEMS FOR EPA

1. EPA will review BP's proposed amendments to the OA and work with the State to adopt the amended OA. **Not resolved.**
2. If requested, EPA is available to assist BPH in undertaking additional financial modeling to better understand various interest rate/program fee scenarios. **In process.**
3. EPA will obtain a determination from Headquarters regarding whether DWSRF Federal financial assistance results in continuing compliance requirements that may require assistance sub-recipients to prepare and submit to the State single audits in fiscal years where the sub-recipients receive less than \$500,000 in DWTRF assistance. **Resolved.**

.